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No. 95-447

Supreme Court, U.S.
FILED
OCT 26 1995
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,
Petitioner,
v.
AMERICAN MEDICAL INTERNATIONAL, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONER

ELLIS J. HORVITZ
MITCHELL C. TILNER
PETER ABRAHAMS
HORVITZ & LEVY
15760 Ventura Boulevard
18th Floor
Encino, California 91436
(818) 995-0800

ROBERT F. LEWIS
DAVID E. REYNOLDS
JANA I. LUBERT
KENNETH D. WATNICK
LEWIS, D'AMATO, BRISBOIS
& BISGAARD
221 North Figueroa Street
Suite 1200
Los Angeles, California 90012
(213) 250-1800

JOHN G. ROBERTS, JR.*
DAVID G. LEITCH
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5810
Counsel for Petitioner

* Counsel of Record

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REPLY BRIEF FOR PETITIONER

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1. Respondent AMI's opposition to certiorari is more noteworthy for what it does not say than what it says.[1] AMI does not dispute that there is a conflict among the circuits over whether a federal court sitting in diversity may create a new state law cause of action not previously recognized by the courts or authorized by the legislature of the State. Nor could it. The Ninth Circuit itself has expressly acknowledged that, "[f]or better or for worse," it departs from "the rule in other circuits" on this question. *Torres* v. *Goodyear Tire & Rubber Co.*, 867 F.2d 1234, 1238 n.1 (9th Cir. 1989). In addition, AMI has no response to our showing in the petition that the Ninth Circuit's activist approach is contrary to the basic principles underlying *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938),

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[1] Petitioner's Rule 29.6 statement appears at Pet. ii.

nor does AMI dispute that the issue arises repeatedly and should be resolved by this Court.[2]

Instead AMI argues that the Ninth Circuit did not create new state law in this case but simply applied existing law. The Ninth Circuit's opinion itself goes far in refuting this assertion; the most that the panel below claimed was that there was dicta indicating there "may" be circumstances in which an insurer "could" be liable for bad faith even in the absence of a violation of its policy. Pet. App. 6a n.4.[3] In any event, the intervening decision of the California Supreme Court in *Waller* v. *Truck Insurance Exchange, Inc.*, 11 Cal. 4th 1, 44 Cal. Rptr. 2d 370 (1995), confirms that the panel in this case was not simply applying existing California law, but instead—mistakenly—creating a new cause of action. *See* Pet. 22-23; *see also infra* at 4-5. The persistent and acknowledged conflict among the circuits on the question whether a federal diversity court may make new state law plainly needs to be resolved by this Court; there could be no better vehicle than a case in which the Ninth Circuit's activist approach led it to a construction of state law that was rejected by the pertinent state supreme court while the federal case was still *sub judice*.

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[2] Prominent examples of the Ninth Circuit's approach—which it recognizes conflicts with the "posture of restraint" that characterizes the approach of other circuits, *Torres*, 867 F.2d at 1238 n.1—continue to multiply, precipitating calls for guidance from this Court. *See, e.g., St. Paul Fire & Marine Ins. Co.* v. *F.H.*, 55 F.3d 1420 (9th Cir. 1995) (decision in diversity case recognizing novel exception to Alaska rule precluding insurance coverage for intentional injuries), *pet. for cert. pending*, No. 95-594 (filed October 11, 1995).

[3] The panel cited one intermediate California case for this assertion—*McMillin Scripps North Partnership* v. *Royal Ins. Co. of America*, 19 Cal. App. 4th 1215, 23 Cal. Rptr. 2d 243 (1993)—but the court in that case in fact confirmed the well-settled California rule that "a bad faith claim cannot be maintained unless policy benefits are due." 19 Cal. App. 4th at 1222, 23 Cal. Rptr. 2d at 247 (quoting *Love* v. *Fire Ins. Exchange*, 221 Cal. App. 3d 1136, 1153, 271 Cal. Rptr. 246, 256 (1990)).

2. We explained in the petition that, if this Court were not inclined to grant review to resolve the conflict over whether a federal diversity court may make new state law, it should at the very least grant the petition, vacate the judgment, and remand to the court of appeals for further consideration in light of *Waller*. *See* Pet. 22-25. We explained that under *Vandenbark* v. *Owens-Illinois Glass Co.*, 311 U.S. 538 (1941), the Ninth Circuit was obligated to conform its decision to this intervening decision of the California Supreme Court, and that this duty persisted "until such time as [the federal] case is no longer *sub judice*." *Id.* at 543. We also explained that when a lower federal court refuses even to consider the intervening state court decision, this Court will grant, vacate, and remand, to ensure that the court of appeals discharges its duty under *Vandenbark*. *See, e.g., Huddleston* v. *Dwyer*, 322 U.S. 232 (1944); *Exxon Co., U.S.A.* v. *Banque de Paris et des Pays-Bas*, 488 U.S. 920 (1988).

Developments since the petition for certiorari was filed have confirmed and heightened the need for action by this Court. In light of the California Supreme Court's decision in *Waller*, we filed with the Ninth Circuit on September 20, 1995, a Motion for Leave to File Untimely Petition for Rehearing; Petition for Rehearing and Suggestion for Rehearing En Banc. This filing followed the procedure sanctioned in *Braniff Airways, Inc.* v. *Curtiss-Wright Corp.*, 424 F.2d 427 (2d Cir.), *cert. denied*, 400 U.S. 829 (1970), and was intended to afford the Ninth Circuit the opportunity to act and consider the significance of *Waller* without the need for intervention by this Court. *See* Opp. App. 6a-9a.

On October 6, 1995, however, the Ninth Circuit denied National Union's motion for leave to file the petition for rehearing. Opp. App. 1a. In doing so, the Ninth Circuit has placed this case squarely on all fours with the facts in *Huddleston* and *Exxon*. In *Huddleston*, *Exxon*, and here, a federal court of appeals in a diversity case entered judgment against the petitioner based on an interpretation of

state law. In each case, a timely petition for rehearing was denied. In each case, the pertinent state court then issued a decision casting doubt on the federal court's construction of state law. In each case, the petitioner then reapplied to the court of appeals, seeking leave to bring the new state court decision to the attention of the court. In each case, leave was denied. In *Huddleston* and *Exxon*, this Court then granted a petition for certiorari, vacated the judgment below, and remanded for reconsideration in light of the intervening state court decision. It should follow the same course here.

AMI has no answer to the controlling significance of this Court's decisions in *Huddleston* and *Exxon*. Indeed, AMI does not even *cite* the cases in its opposition, much less attempt to distinguish them. AMI argues that this Court should deny certiorari because the Ninth Circuit denied National Union's motion for leave to file a petition for rehearing seeking to bring the *Waller* decision to that court's attention. *See* Opp. 15. As *Huddleston* and *Exxon* make clear, however, it is just such a refusal by a court of appeals even to reconsider its judgment that compels this Court to grant certiorari and remand to ensure that the court of appeals adheres to the clear dictates of *Vandenbark*.[4]

Rather than attempting to respond to *Huddleston* and *Exxon*, AMI elects to devote its opposition to arguing that the decision below and the California Supreme Court's opinion in *Waller* can be reconciled. AMI is wrong. AMI's action was for breach of the implied covenant of good faith and fair dealing, and the panel below held that under California law such an action could be maintained even if no policy benefits were due,

[4] AMI is quite wrong to contend that the Ninth Circuit's action on National Union's motion for leave to file a second petition for rehearing somehow obviates the need for action by this Court. The Ninth Circuit has not considered and denied National Union's second petition for rehearing; it has denied National Union leave even to file that petition. *See* Opp. App. 1a.

i.e., even if National Union had a valid coverage defense. As the panel put it, "[e]ven assuming * * * that [National Union] had a valid coverage defense, [National Union] would not be excused * * * from liability for the breach of its duty not to benefit at the expense of its insured. Thus the validity of [National Union's] coverage defenses is not controlling." Pet. App. 7a.

In *Waller*, the California Supreme Court addressed the identical issue, and ruled that the implied duty was triggered "when benefits are due an insured," but that absent "the insured's right to receive the benefits of the contract * * * the implied covenant has nothing upon which to act as a supplement, and 'should not be endowed with an existence independent of its contractual underpinnings.'" 44 Cal. Rptr. 2d at 390 (quoting *Love* v. *Fire Ins. Exchange*, 221 Cal. App. 3d at 1153, 271 Cal. Rptr. at 256). The remedy for "unfair practices that are independent of the insurance contract" is not a cause of action of the sort fashioned by the Ninth Circuit, but instead "administrative sanctions" imposed by the Insurance Commissioner. 44 Cal. Rptr. 2d at 390.[5]

In any event, AMI asks the wrong question in focusing on the merits. In *Huddleston*, this Court vacated and remanded because "[t]he second opinion of the Oklahoma Supreme Court * * * has at least raised such doubt as to the applicable Oklahoma law as to require its reexamination in the light of that opinion * * * before pronouncement of a final judgment in the case by the federal courts." 322 U.S. at 236-237. As the Court explained, "[t]hat doubt is not to be resolved in the first instance by this Court," but instead by the lower federal

[5] AMI contends this case is distinguishable from *Waller* because here there was coverage and the jury found National Union breached its insurance contract. The trouble with this argument, of course, is that the panel below repeatedly refused to address National Union's coverage arguments, holding instead that they were irrelevant to the existence of bad faith liability. *See* Pet. App. 6a n.4, 7a, 8a, 10a.

courts on remand. *Id.* at 237-238. There can be no serious dispute that the California Supreme Court's decision in *Waller* has at the very least cast doubt on the Ninth Circuit's decision to create a new state law tort remedy in this case. Under *Vandenbark* and *Huddleston*, that doubt requires the Ninth Circuit to reconsider its judgment. The Ninth Circuit's refusal even to entertain a petition for rehearing—the same action that prompted this Court's decisions in *Huddleston* and *Exxon*—should lead to the same result here as in those cases.

3. The Ninth Circuit's refusal even to permit the filing of a second petition for rehearing also places the Ninth Circuit in direct conflict with the Second Circuit's decision in *Braniff*. *Braniff* involved a diversity action that turned on Florida law. Following entry of judgment in the Second Circuit and denial of rehearing, the Florida Supreme Court issued a decision casting doubt upon the court of appeals decision. Even though a petition for certiorari seeking review of the Second Circuit decision was pending, plaintiffs—when they learned of the Florida court decision—filed a request in the court of appeals for " 'modification of decision of the court or for enlargement of the time to petition for rehearing.' " *Braniff*, 424 F.2d at 429 (quoting motion). After this Court denied certiorari, the Second Circuit considered whether it should entertain the second request for rehearing based on the intervening Florida decision:

> *Huddleston* seems to indicate that we should. Instead of reversing the court of appeals, and deciding the state law issues itself, the Supreme Court there vacated the court of appeals decision, and remanded to that court to permit it to determine the issues of state law in the first instance, on the basis of the new state court decision. For us to refuse to consider petitions for rehearing under the circumstances present here merely because a petition for certiorari has been filed would be, it seems to us, wasteful, for under the *Huddleston* procedure the Supreme Court would not reach the merits of the controversy, but

> would vacate our decision and order us to reconsider on the basis of the recent state opinion. [424 F.2d at 429-430.]

Several years ago this Court granted certiorari when the Fifth Circuit, like the Ninth Circuit here, placed itself in conflict with *Braniff* by turning aside a filing seeking to raise an intervening state court decision casting doubt on the Fifth Circuit's decision. *Exxon Co., U.S.A.* v. *Banque de Paris et des Pays-Bas*, 485 U.S. 1020 (1988). *See* Pet. for Cert., No. 87-1467 (filed March 4, 1988).[6] In that case this Court eventually followed its prior decision in *Huddleston* and remanded the case to the Fifth Circuit with instructions to do what it had refused to do and what the Ninth Circuit has now refused to do here—reconsider its decision in light of the intervening state court decision. *See* 488 U.S. 920. The Court's grant of certiorari in *Exxon* confirms the importance of the issue, and its disposition reaffirms the continuing validity of *Huddleston.*

4. The questions presented go to the heart of the proper role of federal courts exercising diversity jurisdiction and raise basic federalism concerns. Here the Ninth Circuit—expressly committed to an activist approach to creating new state law under *Erie*—created a new cause of action under California law. While the case was still *sub judice*, the California Supreme Court rejected that cause of action. Rather than conform its judgment to this decision, the federal court refused even to permit the filing of a second petition for rehearing designed to call its attention to that state court ruling. The Ninth Circuit has

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[6] The "Question Presented" in *Exxon* was:

> If after a federal court of appeals has entered judgment in a diversity case, but while the case remains *sub judice*, a state intermediate appellate court decides the controlling issue of state law in a manner that conflicts with the judgment of the federal court, should the federal court vacate its judgment and reconsider in order to ensure adherence to applicable state law? [Pet. for Cert., No. 87-1467, at i.]

lost sight of its limited role in construing state law in diversity, and this Court should grant the petition to reaffirm and clarify that role.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted. In the alternative, the petition should be granted, the judgment vacated, and the case remanded for further consideration in light of the California Supreme Court's decision in *Waller* v. *Truck Insurance Exchange*.

Respectfully submitted,

ELLIS J. HORVITZ
MITCHELL C. TILNER
PETER ABRAHAMS
HORVITZ & LEVY
15760 Ventura Boulevard
18th Floor
Encino, California 91436
(818) 995-0800

ROBERT F. LEWIS
DAVID E. REYNOLDS
JANA I. LUBERT
KENNETH D. WATNICK
LEWIS, D'AMATO, BRISBOIS
& BISGAARD
221 North Figueroa Street
Suite 1200
Los Angeles, California 90012
(213) 250-1800

JOHN G. ROBERTS, JR.*
DAVID G. LEITCH
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5810
Counsel for Petitioner

* Counsel of Record